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Inc.

JUNE 1988

GEARING UP FOR BUSINESS IN THE '90s

Helping Companies to an Aging Portfolio

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The Anatomy of a Start-up

KEN DYCHTWALD OF AGE WAVE IN

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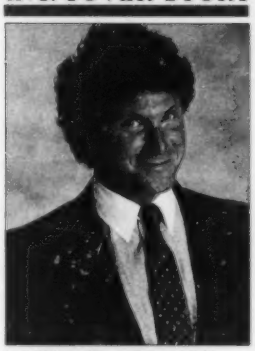

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COVER PHOTOGRAPH
by
Tom Zimberoff

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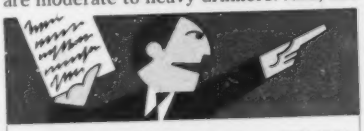
IS YOUR COMPANY HAZARDOUS TO YOUR HEALTH?

We all know that it's tough to run a fast-growing business, but can it threaten your health as well? To find out, we conducted a survey of INC. 500 CEOs in conjunction with General Health Inc., in Washington, D.C., which was itself an INC. 500 firm in 1985 and '86. The results: as hard-driving as these people are, they tend to be a bit *healthier* than a comparable group of people who are not CEOs.

For one thing, the INC. 500 group is relatively smoke-free. More than half of those responding have never smoked, and only 15% smoke cigarettes today. In addition, the CEOs say they exercise an average of four hours a week.

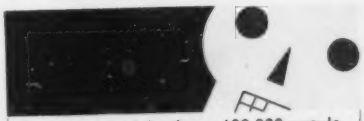
Cigarette smoking:	INC. 500	General Population
Never	51%	43%
Former	34%	27%
Present	15%	30%

They do, however, have a weakness for food and drink. Despite all that exercise, 70% of the respondents weigh more than they should. Almost one-third, moreover, are moderate to heavy drinkers. And, not surprisingly, 78% show clear signs of Type-A tendencies—the driven, competitive behavior that many studies have linked to stress and heart attacks.



Prevalence of Type-A Behavior:	INC. 500
Some Type-A Behavior	22%
Definite Type-A Tendencies	21%
Type-A Personality	57%

All in all, though, the INC. 500 CEOS in our sample lead lives that are slightly more healthy than average, as shown in the 10-year mortality table. Compared with their nonentrepreneurial peers, they run less risk of dying over the next decade from most major causes. One exception: death by automobile accident. Apparently, it's in their cars that successful entrepreneurs let their risk-taking tendencies run wild. —*M.E.M.*



Average risk of death per 100,000 population in next 10 years:

	INC. 500	Matched group*
By heart attack	2,113	2,541
By stroke	292	354
By cancer	1,903	2,383
By automobile accident	454	222
By cirrhosis	655	292
By pneumonia	137	126
Total mortality risk, all causes	7,883	8,223

*A group from the general population, matched with the INC. group by age, race, and sex

THE ENTREPRENEURIAL CHIEF

This year, Phillip J. Stevens did what many entrepreneurs only talk about doing. Having achieved wealth and power, he decided it was time to give something back. So he sold Ultrasystems Inc., the $159-million engineering company he had founded in 1969, and began devoting his full energy to a cause he believed in: securing justice for his people, the Sioux.

Entrepreneur Phillip Stevens
Hero or takeover artist?

To Stevens, justice is a matter of $3.1 billion and 1.3 million acres in South Dakota's Black Hills—land that was stolen from the Sioux, including his great-grandfather, back in 1877. He sees the land and the money as an enormous debt on the national balance sheet, and himself as the bill collector. When he was named special Sioux chief at a ceremony this spring, the press loved it. The public loved it. In fact, just about the only people who didn't love it were many of the Sioux themselves.

Stevens has become a center of controversy within the Sioux nation. He has his supporters, but others consider him a pretender chief and resent his take-charge entrepreneurial style. "The head of a company is, in effect, a dictator," says Gerald Clifford, coordinator of the Sioux's Black Hills Steering Committee. "That's how this man is trying to deal with the Sioux tribes. He's approached this like a corporate takeover. . . . That's not the way it works at this level."

Style aside, Sioux leaders like Clifford fear that Stevens may undermine support for a bill pending in Congress to return the land, and to provide the Sioux with more than $160 million in compensation. "The only thing he's accomplishing so far is jeopardizing the bill and disunifying the reservations," says Ben Black Bear, another Sioux involved in the steering committee. The dispute has grown so acrimonious that one group filed a complaint in U.S. district court, charging Stevens with, among other things, impersonating an Indian.

Stevens, who says he is three-sixteenths Sioux, is undeterred by his critics, attributing their skepticism to past experiences with duplicitous outsiders. As for the bill in Congress, he thinks $160 million in compensation is far too little, since it is based on simple, instead of compound, interest over 111 years. With the confidence of a self-made man, Stevens believes he can lead the Sioux to a larger victory by convincing the government to pay the full $3.1 billion. But, unless he can unify the Sioux behind him, he may face a long, lonely battle. —*M.E.M.*

ILLUSTRATIONS: NIGEL HOLMES

BUYER BEWARE

When growth companies change hands, both buyers and sellers are in for a surprise

BY DAVID L. BIRCH

For many growth-company owners, finding an acquirer is the ultimate dream. How better to cash out? Few companies ever go public (only 5% of all corporations are publicly held). And not many growing businesses are logical candidates for transfer to the next generation under terms that include a cash buyout of mom or dad. So getting someone to purchase all or most of your company is the easiest way to harvest what those years of hard work have sown. Especially if you want to stay on after selling out, happy for the cash in the bank but eager for the chance to run your company with resources you never had before.

Unfortunately, few company heads look beyond the actual acquisition and think about what will happen to their businesses after they've been acquired. And from what we can see, relatively few *acquirers* look much beyond the acquisition decision either.

So we decided to do exactly that. For those thinking of shopping their companies and, too, those thinking of buying, our findings will provide a peek into the room on the other side of the acquisition door. We looked into our Cognetics database at two different periods of time: once in the 1970s and once in the 1980s. In the process, we studied 10,500 acquired companies and contrasted their experiences with those of 1.4 million comparable companies that were not acquired. The results for both periods are virtually identical, so we'll focus on the more recent one, in the 1980s.

From the start, we had a premise: the wave of mergers and acquisitions sweeping the country must be based on benefits that a large company can bring to a smaller one. The larger company would have the resources—capital, marketing expertise, and so on—needed to leverage the bright idea embodied in the smaller one, and to keep the smaller one afloat in hard times.

FIGURE 1

GROWTH OF ACQUIRED AND NONACQUIRED COMPANIES, 1981–85

Company Groups by Total Two-Year Growth	Average Annual Growth Rate of Acquired Companies			Average Annual Growth Rate of Nonacquired Companies		
1981–83	81–83	83–85	change	81–83	83–85	change
More than 15%	30.4%	1.6%	−28.8%	29.8%	2.6%	−27.2
10–15%	5.9	1.8	−4.1	6.1	1.5	−4.6
5–10%	3.6	−1.0	−4.6	3.7	1.4	−2.3
0–5%	1.4	2.3	0.9	1.5	0.9	−0.5
Decline	−18.0	4.1	22.0	−17.3	4.8	22.1

Growth not for sale: what happens to companies that get bought
As their acquirers have learned, fast-growing firms usually don't keep growing fast.

Following this basic logic, we might expect a real surge of growth in the smaller businesses after acquisition—a surge that would carry them beyond the still-struggling, resource-starved companies that never get acquired.

Since growth is the issue, we divided companies into groups based on their growth from 1981 to 1983, then we compared the performance of those that were acquired at the end of 1983 with the performance of those that weren't.

So much for theory. The acquiring companies may have thought they were buying growth that they could accelerate, but in fact what they bought was a huge and sudden slowdown (see figure 1). The average rapidly growing acquired company was growing at a compound rate of 30.4% per year from 1981 to '83. By 1983 to '85, its growth had slipped to less than *one-fifteenth* of that level (1.6%). Fast-growing businesses that stayed on their own also slowed down a great deal (a phenomenon to which we'll turn in next month's column), but they did a *better* job, not worse, of somehow countering the letdown than their acquired counterparts did.

Those few buyers that acquired declining businesses with the hope of turning them around succeeded admirably, but did no better at the turnaround game than the businesses left to their own devices. In fact, nonacquired declining companies were declining slightly less in 1981 to '83 than acquired decliners, and were able to convert decline into growth slightly better.

Well, the argument might go, maintaining growth is a tough game any way you play it. At least the acquired businesses will be better protected from failure with all the acquiring company's resources behind them. Wrong again. Acquired companies are much more likely to be liquidated than those that toughed it out on their own, regardless of how well either group was doing in the previous two years (see figure 2).

As I mentioned earlier, there is nothing new, or unique to the 1980s, about these patterns. Nearly the same results show up among the 1969 to '76 data. *(continued)*

FIGURE 2

FAILURE RATES OF ACQUIRED AND NONACQUIRED COMPANIES, 1981–85

Company Groups by Total Two-Year Growth	Acquired Companies That Closed	Nonacquired Companies That Closed
1981–83	83–85	83–85
More than 15%	11.2%	8.1%
10–15%	9.6	5.3
5–10%	5.3	5.0
0–5%	6.7	4.5
Decline	14.6	11.4

Acquired companies are more likely to be liquidated.
Deep pockets haven't kept growth companies afloat.

CHARTS: NIGEL HOLMES

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THE NEW ECONOMY

There are some lessons in all this. The young, growing company dreaming of acquisition as a logical tactic in its campaign of conquest should prepare for a letdown. You can't expect your baby to be the same in the hands of different parents. In general, your baby's growth is likely to be severely stunted. There's even a good chance the baby will be thrown out with the bathwater. So make sure you get a good price when you sell, because it might be the last satisfaction you get.

If you are in the business of acquiring businesses, don't count on being able to buy growth and innovation. Statistically, at least, buying it appears to kill it.

There are many logical arguments about how added resources and logical fit with a new parent will send a smaller company spiraling to new heights. But the arguments in most cases turn out to be wishful thinking, not sound theory. The logic is overridden by the loss of the original spirit and drive that made the company grow in the first place. You must think long and hard about how to retain and nurture the innovative spirit of the acquired company rather than to squash it with "professional management" or big-company procedures. It can, and has, been done—but not by accident, and not very often.

From a broader perspective, it might seem that all of the above adds up to an overwhelming indictment of mergers and acquisitions. Not at all. Remember that the number of acquired companies, and the jobs associated with them, are almost insignificant (less than one-tenth of 1% per year). For every company that is acquired, there are literally thousands that dream about it. It's what got many of them started, and it's what keeps most of them going.

Acquisition is a pot of gold at the end of the rainbow, and for many it's the only pot. To remove the pot because some of the gold is a little tarnished would be a huge mistake. It would remove the main incentive that drives the majority of growing, innovative companies in the United States. Also, what happens to acquired companies isn't that much worse than what nonacquired companies manage to do to themselves.

A more useful conclusion is that companies should be realistic about what can be achieved through acquisition, and that both parties to a transaction should think carefully about how to make the union work. It's usually a marriage of clashing cultures. And it requires more than the usual amount of sensitivity and effort if it is to succeed. □

David L. Birch is president of Cognetics Inc., in Cambridge, Mass., and director of MIT's Program on Neighborhood and Regional Change.

HANDS ON

A Manager's Notebook

PERSONAL BUSINESS

KEEPING PRIVATE LIFE PRIVATE

Among the problems faced by company builders who also happen to be parents is what to tell the staff when family matters intrude. Employees can develop both envy and disrespect when they see their boss leaving work on child-related errands—and as a result the office atmosphere can suffer.

Nancy Creel, vice-president and cofounder with her husband, Wes, of Creel Morrell Inc., in Houston, has found a simple solution: "When I need to see my children, I just say I have an appointment.

"I have a sense of privacy that is critical to keeping the children and the venture separate and on an even keel," says Creel, who now has three children under age six. "It's to no one's benefit at the office to know I'm in a pediatrician's waiting room."

By preventing the issue from surfacing, she says, jealousies and concerns about her professional commitment are never aroused, and she never needs to do the sort of thankless explaining that many founders are forced to attempt. "What people don't know, of course, is that I spend time on work at home and I don't ask for credit for that. The credits and debits balance each other out." □

MANAGEMENT

BOARDROOM EDUCATION

If you're like many CEOs, your idea of a good board of directors candidate is the no-nonsense, battle-hardened executive you see yourself one day becoming. That's fine, but to judge by Joe Crugnale's experience, maybe you should check out ivory-tower intellectuals, too. An out-of-the-mainstream professor may have a wonderful view of your business's marketplace.

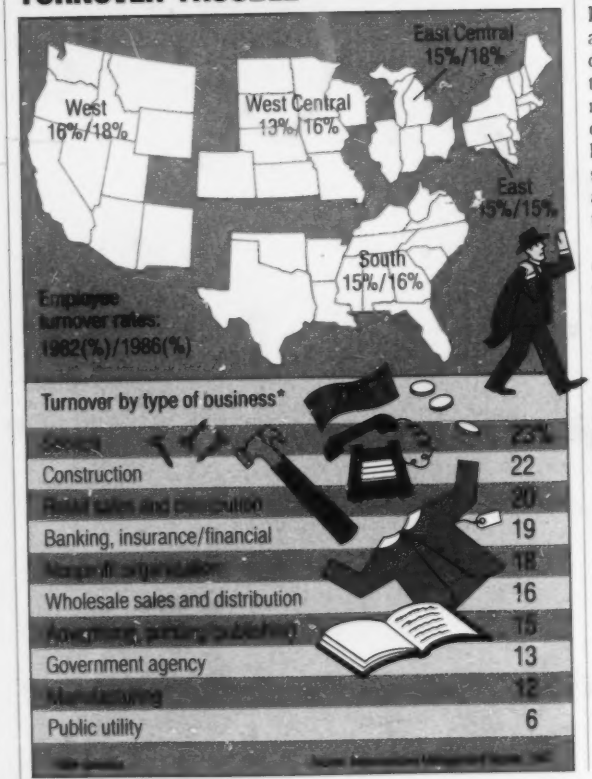
Two years ago Crugnale, CEO of Bertucci's and Bailey's, two small regional restaurant chains, recruited Bert Mendelsohn, a professor of marketing at Boston College who specializes in tracking small food-service chains.

"His classes do all my market research and provide me with a lot of information on the competition," says Crugnale. First hired as a consultant, Mendelsohn immediately helped Crugnale with the nuts and bolts: understanding an operating statement, and determining the ratios needed to make his restaurants more competitive.

In short order, Mendelsohn was elected to the board to help plan long-term strategy. For someone like Crugnale, who runs his business primarily by intuition, the mercilessly logical approach of an academic can serve as an effective counterbalance. □

PERSONNEL

TURNOVER TROUBLE



COMMUNICATIONS

JUST THE FAX

If your business doesn't need a facsimile machine every day, but you're convinced that using one could help make a big sale or meet tough deadlines, you may be in luck. A number of printing shops and delivery services are now hustling to meet that demand.

Sir Speedy Inc., a franchise chain of 820 print centers, is one of them. To help the fax have-nots do business with the haves (the number of facsimile machines in use will double to 1 million in the next three years) Sir Speedy has developed Faxshare.

By joining for a $12 monthly fee, you'll cut in half the cost of faxing through Sir Speedy—from $10 to $5 for the first five pages, and down to 50¢ for each additional page. As a member, you get pickup and delivery of your jobs for free, and you can put your Sir Speedy fax number on your business card.

The program's toll-free number is (800) FASTFAX. □

MANAGING PEOPLE

THE BIG-SHOT TREATMENT

To encourage his employees to do a good job, Ken Hendricks tries to make each one of them feel like the most important person in his company.

Hendricks, CEO of ABC Supply Co., which runs wholesale roofing and siding centers throughout the country, had a serious problem with truck maintenance two years ago. Instead of issuing a memo, Hendricks flew his mechanics to company headquarters in Beloit, Wis. "That showed the seriousness of it," he says. "If I had sent a memo out, it would have been like putting a notice on the bulletin board."

The mechanics loved it, and Hendricks was so pleased with the results that he held another meeting with them this May. □

DIAGRAMS: CYNTHIA DAVIS

HANDS ON

QUOTE OF THE MONTH

"Need furniture cheap? Just watch VC-backed start-ups—they've always got the poshest stuff—and wait for the liquidator. We get our best equipment that way."

—David L. Birch, president of Cognetics Inc., on outfitting your office on a budget

MARKETING

IF IT AIN'T BROKE, IT'S AN ASSET

In need of a fresh competitive edge? Maybe your company already has one, and you just haven't looked for it hard enough. Take the case of Steve Rondel, president of $1.8-million Advanced Products & Technologies Inc.

Rondel was standing in the mail room of his Redmond, Wash., business when he realized that very few customers were returning the portable coffee makers, hair dryers, and other travel products he makes.

Then the light bulb went on. The reliability of his company's products could be exploited. Why not offer a five-year warranty as a way to differentiate Advanced Products from the pack? Given the low return rate, what could it cost?

Virtually nothing, as it turned out, and the payoff can be enormous, especially if yours is a higher-priced line. The warranty, says Rondel, tells consumers the product is worth it. □

OPERATIONS

THE DIRTY WORK

Next time you sign a hefty check to an outside janitorial or maintenance service, think about addressing it to your own employees.

When Harry Brown, president of Erie Bolt Corp., in Erie, Pa., cut his janitorial staff to reduce payroll, he thought of contracting the work out. His employees had a better idea—they wanted to bid on the jobs themselves. Several employees said they would like the added income and would be willing to do the work after hours and on weekends. In fact, they would undercut the outside contractors' prices. Brown decided to give them a shot.

Now, the president of the union does Erie Bolt's snow-plowing, and three employees and one company retiree come in regularly to clean the shop and maintain the equipment. They also paint and do minor repairs.

"We're paying less, and there is no doubt that we're getting better service," Brown said. "The employees know the place better, and if they don't do a good job, they know the other employees will get on their case." □

BUSINESS TRAVEL

NEWS YOU CAN USE

You could make a full-time job out of keeping up with frequent-flyer and hotel/motel discounts. Look into an eight-page monthly newsletter called *Travel Smart for Business*, and maybe you won't have to.

Travel Smart alerts you to the latest air, hotel, and rental-car rates in the United States and around the world. It also includes safety tips, currency statistics, valuable information about the circus-like airline industry, and city reports on hotels, restaurants, tours, museums, and clubs worth checking out. One recent issue reported on the likelihood of your being involuntarily bumped, airline by airline. (The odds range from 0.1 passengers for every 10,000 booked on American Airlines to 17.2 on Pan Am.)

For more on *Travel Smart*, write Communications House Inc., 40 Beechdale Road, Dobbs Ferry, NY 10522. It costs $125 per year. □

OPINION

JUDGMENT

Do you agree that management is too tolerant of poor performers?
Disagree 26%
Agree 44%
Partly agree/ disagree 30%
Z Z Z Z
SOURCE: THE WYATT CO., WYATT WORKAMERICA SURVEY, 1987

Nearly half of those surveyed believe that managers are too t[illegible]rant of poor performers.

RECRUITING

HELP ON THE STREET

When you need unskilled or entry-level employees, one way to find them is embarrassingly simple: pay attention to the general public you deal with every day. Blair Brown, CEO of Charrette Corp., a chain of architecture- and design-supply stores based in overemployed metropolitan Boston, considers everyone he meets in passing as a possible Charrette staff member. "I told my personnel department they have to develop guerrilla strategies so the business can grow," Brown says. To date, the tactic has paid off in the hiring of eight people—good results, considering its beginnings.

When Brown's car broke down during a late-night snowstorm some winters ago, he walked until he found an off-duty taxi. The sympathetic driver was nice enough to interrupt his coffee break and take Brown home. Brown didn't simply acknowledge the extra effort in the cabbie's tip. He offered him a job as a driver. Today, that driver is a marketing specialist.

"I like to see people and meet the public," says Brown. "By chatting with the taxi driver I found out he was a graduate of Amherst College and didn't have any plans." Brown also makes it a rule to forgo the self-serve pump at gas stations. Unpinched pennies at the pump have rewarded him with one especially courteous attendant who was ready to come in from the cold. □

Reported by Sara Baer-Sinnott, Leslie Brokaw, Paul B. Brown, Teri Lammers, Amy Schulman, and Stephen D. Solomon